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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1982

WESTINGHOUSE ELECTRIC CORPORATION, *Appellant*,

vs.

JAMES H. TULLY, JR., et al.,
As The Tax Commission Of The State Of New York,
Appellees.

On Appeal From The Court Of Appeals Of The State Of New York

BRIEF OF THE STATE OF CALIFORNIA AS AMICUS CURIAE IN SUPPORT OF BRIEF OF JAMES H. TULLY, JR.

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INTEREST OF THE AMICUS CURIAE

The state of California, pursuant to Rule 36.2 of the Rules of the Supreme Court of the United States, submits this brief as amicus curiae in support of the Appellees, James H. Tully, Jr., et al.

The state of California imposes a franchise tax and a corporate net income tax (Cal. Rev. & Tax Code §§ 23001 et seq.) on corporations incorporated, qualified, doing busi-

ness in or having income from sources in California. In determining the amount of income of a corporation that is properly attributable to activities within its jurisdiction, California relies upon the unitary business principle which encompasses both formulary apportionment and the combined report procedure. (*Container Corporation of America v. Franchise Tax Board*, Docket No. 81-523, decided June 27, 1983.)

The state of California also provides credits, deductions and exemptions to encourage corporations to make investments in various properties or engage in particular activities within California which have been determined to be beneficial to the population and economy of the state as a whole. These include, but are not limited to: (1) procuring of goods and services in California (Rev. & Tax. Code § 23101.5(a)(1)), (2) sending employees to California educational institutions (Rev. & Tax. Code § 23101.5 (a)(2)), (3) use of solar energy devices (Rev. & Tax. Code § 23601), (4) use of energy conservation measures (Rev. & Tax. Code § 23601.5), (5) improved agricultural irrigation equipment (Rev. & Tax. Code § 23602), (6) conversion of cars and trucks to use alcohol (Rev. & Tax. Code § 23603), (7) installation of pollution control equipment (Rev. & Tax. Code § 23604), (8) employee ridesharing programs (Rev. & Tax. Code § 23605), (9) use of solar-powered irrigation pumps (Rev. & Tax. Code § 23606), (10) foreign-flag sea and air carriers (Rev. & Tax. Code § 24320), (11) targeted jobs credit (Rev. & Tax. Code § 24330), (12) child development service facilities (Rev. & Tax. Code § 24371.5), and (13) forest land improvements (Rev. & Tax. Code § 24372.5). Each of these credits, deductions or exemptions

is only available with respect to activities and investments in California regardless of the fact that a taxpayer's activities are carried on throughout the world.

The state of California's interest in this issue is substantially identical to that of the state of New York. The propriety of the combined report or consolidated return methodology involves more than $1.7 billion in annual revenues to California. The credits, deductions and exemptions given solely with respect to California activities exceed $3.2 million annually. The state of California has a vital interest in the proper application of the unitary business principle and in its ability to encourage appropriate business expenditures and locational decisions.

Under Rule 36.4 of the Rules of the Supreme Court of the United States, the state of California is not required to obtain the consent of the parties to file an amicus curiae brief.

SUMMARY OF ARGUMENT

Westinghouse Electric Corporation (Westinghouse) and Westinghouse Electric Export Corporation (Export) are engaged in a unitary business; therefore, the use of a combined report or consolidated return to determine the income attributable to New York is proper.[1]

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[1]A distinction should be made between a combined report and a consolidated return. A consolidated return treats the activities of several corporations as if they were conducted by a single corporation. The corporate boundaries are ignored. (See Internal Revenue Code, §§ 1501, et seq.) A combined report is a method of accounting for the results of a unitary business and apportioning the results between jurisdictions. In the case of a multicorporate unitary business, a combined report cumulates the income and

Under the decisions of this Court, New York is permitted to tax only that income which is properly assigned or attributable to activities or sources within its boundaries. Where a unitary business in involved, this Court has held that the use of the three-factor apportionment formula results in only New York income being taxed by New York.

New York's credit for DISCs' sales does not discriminate between DISC income attributable to New York and DISC income attributable to other jurisdictions because New York claims no jurisdiction over DISC income, or any other income, properly assignable to other states and therefore assesses no tax on such income. New York's tax is measured only by income which is properly assignable to New York and its DISC credit is limited to the tax arising from DISC sales in New York.

To hold that the New York tax and credit here involved is invalid would constitute a rejection of the unitary business principle, would represent an unwarranted interference with internal state tax policy and would, as a logical consequence, require every state to assess and collect a corporate income tax at a uniform rate.

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apportionment factors of each of the unitary activities of each of the corporations and reassigns income amongst the corporations on the basis of the apportionment formula. The income and factors of any of the corporations that are unrelated to the particular unitary business are excluded from the combined report. Each individual corporation then must compute and pay its own tax based upon the total of the unitary or business income apportioned to its activities in the state and its other income assigned to the state. (Frank M. Keesling and John S. Warren, "The Unitary Concept in the Allocation of Income," 12 Hastings Law Journal 42 (1961); Frank M. Keesling, "A Current Look at the Combined Report and Uniformity in Allocation Practices," 42 Journal of Taxation 107 (1975).)

ARGUMENT

I.

WESTINGHOUSE AND EXPORT ARE ENGAGED IN A UNITARY BUSINESS; THEREFORE, THE USE OF A COMBINED REPORT OR CONSOLIDATED RETURN IS APPROPRIATE

In noting probable jurisdiction in this matter, this Court held that the second question presented by the jurisdictional statement, whether New York State's practice of combining the income of a DISC with that of its parent violates various provisions of the Constitution, was dismissed for want of a substantial federal question (Justices Stevens and Marshall dissenting on procedural grounds).

This holding is clearly correct. Nonetheless, the proper consideration and disposition of the matter before this Court is to a large extent dependent upon the unitary business principle as applied in state corporate income taxation, for it is the unitary business principle which is the linchpin of apportionability (*Mobil Oil Corp. v. Commissioner of Taxes,* (1980) 445 U.S. 425, 439). Therefore, as a preliminary matter, it is appropriate to establish that a unitary relationship exists between Westinghouse and Export.

For a unitary business to exist, there must be "contributions to income resulting from functional integration, centralization of management, and economies of scale." (*Mobil Oil Corp., supra,* 445 U.S. 438; *F. W. Woolworth Co. v. Taxation and Revenue Department,* (1982) ..... U.S. ..... [73 L.Ed. 2d 819].)

Export is a wholly owned subsidiary of Westinghouse (Joint Appendix (JA) 8 & 42). It was organized and operates as a commission agent for Westinghouse and its affiliates for export sales of products and related services (JA 9 & 42). Export is qualified as a Domestic International Sales Corporation under § 992(a) of the Internal Revenue Code (JA 8 & 42). This status provides beneficial federal tax treatment of sales made in foreign commerce in order to encourage export sales and improve the United States balance of payments (Brief of Appellant (BA) 11-13). Export's commissions were $25,987,000 in 1972, of which $19,880,000 were from Westinghouse, and $57,948,738 in 1973, of which $47,180,132 were from Westinghouse (JA 7). All other commission income was received from affiliates (JA 42-43). Export has no employees of its own and it does not own any real or personal tangible property or pay any real estate rentals (JA 9).

The relationship between Westinghouse and Export clearly satisfies the requirements of *Mobil* and *Woolworth* for the finding of a unitary business. Export's existence and ability to function are solely related to its parent company's desire to obtain preferential federal tax treatment for export sales. It is functionally integrated in the fullest sense possible. It is centrally managed *and staffed,* as shown by its lack of employees or an office (JA 9). It gives rise to economies of scale as a device created to facilitate increased sales of Westinghouse products. Its contribution to the income of the Westinghouse group through reduced or deferred federal taxation is direct and apparent. To paraphrase the Court's decision in *Mobil:*

> "Transforming the same income [of Westinghouse] into [the income of Export] works no change in the

underlying economic realities of a unitary business, and accordingly it ought not to affect the apportionability of the income. . . ." (445 U.S. 441.)

II.

AS REQUIRED BY THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT, NEW YORK STATE IS TAXING ONLY INCOME WHICH IS PROPERLY ATTRIBUTABLE TO ACTIVITIES OR SOURCES WITHIN ITS TAXING JURISDICTION

Westinghouse, in its Jurisdictional Statement, made no allegation that the New York tax and credit here in issue give rise to the taxation of extraterritorial values or violate the Due Process Clause of the Fourteenth Amendment. But now for the first time in the Brief of Appellant, Westinghouse asserts that New York is taxing extraterritorial values. It does so by stating that New York taxes the total income of Export (BA 6, 9 & 17) and by alleging that the failure to include the factors of Westinghouse affiliates for which Export makes commission sales in the apportionment formula subjects all of Export's income to tax (BA 6, 20-22). Not only is this argument inappropriate and not properly before this Court (Rule 15.1(a) *Quilloin v. Walcott* (1978) 434 U.S. 246, 253 Fn 13; *Phillips Chemical Co. v. Dumas School District* (1960) 361 U.S. 376, 386 Fn 12), it is also in error.

In *Exxon Corp. v. Wisconsin Department of Revenue* (1980) 447 U.S. 207 at 220, this Court restated its previous determination that the Due Process Clause of the Fourteenth Amendment requires that for a state tax to be valid there must be " 'a rational relationship between the income attributed to the State and the intrastate values of the

enterprise.' Mobil Oil Corp., supra. See Moorman Mfg. Co. v. Bair [437 U.S. 267] at 272-273 . . . National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 756 . . . Norfolk & Western R. Co. v. State Tax Comm'n, 390 U.S. 317, 325. . . ." This Court then went on to reaffirm its position that when a taxpayer is a unitary business, "a State may apply an apportionment formula to the taxpayer's total income in order to obtain a 'rough approximation' of the corporate income that 'is reasonably related to the activities conducted within the taxing State.' Moorman Mfg. Co. v. Bair, ..." (*Id.* at 223.) For a taxpayer to successfully attack an apportionment formula, it must show extraterritorial values are being taxed. (*Butler Brothers v. McColgan* (1942) 315 U.S. 501; *Mobil Oil Corp. v. Commissioner of Taxes, supra,* 445 U.S. 425; *Exxon Corp. v. Wisconsin Department of Revenue, supra,* 447 U.S. 207.)

Westinghouse attempts to meet this burden by stating that the formula used by New York excludes the "affiliates' receipts, property and payroll from the apportionment formula." But New York is not including the income of Westinghouse's affiliates in the base to which it applies its apportionment formula. Therefore, there is no reason to include the affiliates' factors in the apportionment formula. To include the factors of the affiliates would cause the formula to assign part of the income to the affiliates when there has been no allegation the affiliates are part of the unitary business. Furthermore, Westinghouse neglects to mention that Export's commissions from affiliates are included in the apportionment formula and that none of these commissions are assigned to New York (JA 17). New York

has included Export's income in the base subject to apportionment and therefore has correctly included Export's factors in the apportionment formula.

III.

THE NEW YORK CREDIT FOR DISC SALES DOES NOT DISCRIMINATE AGAINST DISC SALES MADE FROM OTHER STATES AND THEREFORE DOES NOT VIOLATE EITHER THE COMMERCE CLAUSE OR THE EQUAL PROTECTION CLAUSE OF THE FOURTEENTH AMENDMENT

The gravamen of Westinghouse's argument is that "the franchise tax in this case imposes a greater tax liability on out-of-state sales than on in-state sales . . ." (JA 10). This statement is simply not true.

A necessary premise to the argument advanced by Westinghouse is that New York is taxing sales or more properly, income, attributable to other states (BA 16, 17 & 20). For if New York is taxing only New York income, there can be no discrimination or denial of equal protection with respect to sales or income arising in other states. New York would be doing nothing with respect to such sales or income.

That is precisely the fact in this case. As shown in Argument II above, the Due Process Clause of the Fourteenth Amendment restricts New York's power of taxation to income properly attributable to New York. The taxation of any other income would be impermissible. Since New York is not taxing income or sales from other jurisdictions, it is impossible for it to discriminate against such sales or income or to deny equal protection with respect to such sales or income.

Westinghouse, in its brief, relies on this Court's decisions in *Boston Stock Exchange v. State Tax Commission* (1977) 429 U.S. 318 and *Maryland v. Louisiana* (1981) 451 U.S. 725, but ignores the critical distinctions between the incidences of taxation in those cases and the New York tax here involved.

In *Boston Stock Exchange*, the tax involved was a transfer tax. The tax was imposed on residents and nonresidents on any sale, agreement to sell, memoranda of sales, delivery or transfer of equity securities occurring in New York. If any one of the incidents of taxation occurred in New York, the tax was imposed and based on the *total* value and number of shares involved. Whether the transactions were wholly intrastate or included interstate elements, they were taxed in full. After the tax was determined, a credit was then given to encourage use of New York exchanges.

In *Maryland v. Louisiana*, the tax involved was a "first-use" tax on the *full* quantity of gas imported into Louisiana that had not previously been subject to tax. Exemptions and credits from the tax were granted to users within Louisiana and for parties subject to the Louisiana severance tax.

In both cases, the tax was applied to the full value of the transaction. No effort was made to apportion the tax in any manner. In the instant case, there has been a full apportionment and the tax here assessed and credit here granted apply only to New York activities.

The deficiencies in Westinghouse's position are shown by two simple examples.

First, let us suppose that New York had determined to abolish its income tax with respect to DISC sales by refusing to include any DISC income in the apportionable base. Although this would make New York a more attractive place from which to make DISC sales, would this be constitutionally impermissible? Clearly not. In fact, it would place New York on an equal footing with a number of other states including several out of which Westinghouse's DISC sales are presumably made. (Prentice Hall All-States Tax Handbook-1983 ¶ 222-A)

Second, what if New York had gone a step further and had abolished its corporate income tax? It would certainly make New York a more attractive state for any business to locate or to concentrate its activities in as compared to states with corporate income taxes. Would this be invalid? Of course not. But the logical consequence of accepting Westinghouse's argument is that the abolition of the corporate income tax would be invalid. Furthermore, it would require the Court not only to establish corporate income taxes for Nevada, South Dakota, Texas, Washington and Wyoming but also to establish uniform rates for all states.

Westinghouse, in its argument, ignores the closing admonition of *Boston Stock Exchange v. State Tax Commission, supra,* 429 U.S. 318, 336-37, that "Our decision today does not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry. Nor do we hold that a State may not compete with other States for a share of interstate commerce; such competition lies at the heart of a free trade policy. We hold only that in the process of competition no State may discriminatorily tax the products manufactured or the business operations performed in any other State."

CONCLUSION

New York, through the application of a three-factor apportionment formula to the consolidated or combined income of Westinghouse and its unitary subsidiary Westinghouse DISC, has determined the amount of income which is properly attributed to New York. New York has the right, as does every other state, to tax the income in full, in some part or not at all. The exercise of this right by New York to compete with its sister states for export sales activity in the circumstances of this case in no way discriminates against either interstate or foreign commerce and does not deny Westinghouse equal protection under the law as required by the Fourteenth Amendment. Thus, the New York tax should be sustained.

Respectfully submitted,

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